...MITTED Jan 12 27

Petition and Transcript of Record

Supreme Court of the United States

OCTOBER TERM, 1927

No. 162

SAMUEL J. KORNHAUSER, PETITIONER,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED JANUARY 12, 1927

CERTIORARI GRANTED APRIL 11, 1927

(22,396)

(32,396)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926

No. 829

SAMUEL J. KORNHAUSER, PETITIONER,

vs.

THE UNITED STATES.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

INDEX.

	Original	Print
Petition for a writ of certiorari	a	1
Record from Court of Claims	1	4
History of proceedings	1	4
Amended petition	2	5
Demurrer	7	7
Argument and submission of demurrer	7	7
Opinion, Moss, J.	8	7
Judgment	10	9
Clerk's certificate (omitted in printing)	11	
Order allowing certiorari		9

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., JANUARY 24, 1927.

[fol. a]

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926

No. 829

SAMUEL J. KORNHAUSER, Petitioner,

v.

UNITED STATES OF AMERICA, Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS. — Filed January 12, 1927

To the Honorable Supreme Court of the United States:

Your petitioner, Samuel J. Kornhauser, by his attorney and counsellor, respectfully prays for a writ of certiorari to review the judgment of the United States Court of Claims in the above entitled cause.

Question Involved

The petitioner paid for the calendar year 1918 what he alleges to have been excessive income taxes arising through the refusal of the Commissioner of Internal Revenue to per [fol. b] mit him to deduct from his gross income for that year the sum of ten thousand dollars ($10,000.00), being the amount paid by the petitioner during the year 1918 for attorneys' fees expended by petitioner in defending in the courts of the State of Ohio an action against him for an accounting instituted by his former copartner, the said action growing directly out of the conduct of the business of petitioner and his former copartner in the practice of law in the City of Cleveland in said State, it having been alleged by petitioner's said copartner that petitioner had collected fees or compensation for professional services performed during the existence of the copartnership, to a division of which the said copartner claimed to be entitled. The said copartner charged that subsequent to the dissolution of the partnership your petitioner had received cer-

tain fees consisting of stock in the National Tool Company in payment for legal services performed during the existence of the partnership. Your petitioner resisted successfully the claims of his former copartner throughout all the courts in Ohio, wherein the case was heard and the said expense which he paid his attorneys was claimed by your petitioner as a necessary expense incurred in connection with his business within the meaning of sub paragraph (1) of Section 214 (a) of the Revenue Act of 1918 or else a loss incurred in connection with his business within the meaning of sub paragraph (4) of said Section 214 (a) and in either event deductible from his gross income within the purview and meaning of the Revenue Act of 1918 for the purpose [fol. 6] of determining his net income upon which his liability for taxes depends.

The Court of Claims holds that the payment of these attorneys' fees was neither a necessary expense arising or resulting from the carrying on of the petitioner's business nor that it was a loss incurred in or resulting from the carrying on of any business by the petitioner, but that the payment of these attorneys' fees comes within the purview of Section 215 of the Revenue Act of 1918 which provides that in computing net income no deduction shall be allowed in respect of personal, living or family expenses.

Reasons Relied on for the Allowance of the Writ

The writ herein sought should issue for the following reasons:

1. The Court of Claims has decided an important question of Federal law which has not been, but should be, settled by this Court.

2. The decision of the Court of Claims tends to place attorneys' fees paid unwarily and unnecessarily incurred by a taxpayer in defending himself in connection with a matter arising directly out of the business in which he was engaged in the category of a subsidiary personal expense, thus discriminating in the character of expenses that a taxpayer may incur or a loss which he may suffer resulting from [fol. 7] the carrying on of his business.

3. The effect of the decision of the Court of Claims is to penalize a taxpayer who undertakes to defend himself against a spurious claim arising in connection with the business in which he is engaged.

4. The Court of Claims has decided a question of Federal law in a way which seriously affects the inherent rights of every citizen of the United States who is engaged in business and subject to the payment of Federal income taxes.

5. This Court has granted at this term, to wit, on October 11, 1926, a petition for certiorari to the Circuit Court of Appeals for the Third Circuit in the case of Lewellyn, Collector, v. Electric Reduction Company, No. 294, October Term 1926, wherein there is involved one of the vital questions arising in this case, namely, what constitutes a loss sustained in carrying on a trade or business? Neither that question nor the other questions involved in the present petition have been passed upon by this Court.

Wherefore your petitioner respectfully prays that a petition for a writ of certiorari to review the judgment of the Court of Claims be granted.

L. L. Hamby, Attorney for Petitioner.

[fols. 6 & 7] DISTRICT OF COLUMBIA, ss:

L. L. Hamby, being first duly sworn, states that he is the attorney and counsellor for the petitioner named in the foregoing petition and has particular knowledge of the matters and things set forth therein and of the proceedings in the above entitled action; that he has read the foregoing petition subscribed by him and knows the contents thereof, and that the facts therein stated are true.

L. L. Hamby.

Subscribed and sworn to before me this 12th day of January, 1927. Lucille C. Stone, Notary Public, D. C. My commission expires January 30, 1929. (Seal Lucille C. Stone, Notary Public, District of Columbia.)

I hereby certify that I have read the foregoing petition and that in my judgment the petition is well founded as to matters of fact and as to matters of law, and that the case identified thereby is one, and is such, that the prayer of the petitioner should be granted by this Honorable Court.

L. L. Hamby, Attorney and Counselor for the Petitioner.

[fol. 1] In Court of Claims of the United States

No. E-343

Samuel J. Kornhauser

vs.

The United States

I. History of Proceedings

On October 22, 1925, the plaintiff filed his original petition.

On December 21, 1925, the defendant filed a demurrer to said petition.

On January 12, 1926, the demurrer was argued and submitted by Mr. J. H. Sheppard, for defendant, there being no appearance for the plaintiff.

On February 1, 1926, the court, in an opinion by Campbell, Ch. J., sustained the demurrer and dismissed the petition.

On March 27, 1926, the plaintiff filed a motion to vacate judgment and for re-hearing and for leave to file an amended petition, which amended petition was presented with the motion.

On April 12, 1926, the court entered the following order on said motion:

Order

In this cause the plaintiff having made a motion to file an amended petition, it is ordered by the court this 12th [fol. 2] day of April, 1926, that its former order dismissing the petition be and it is vacated, and the plaintiff has leave within thirty (30) days to file an amended printed petition.

H. AMENDED PETITION—Filed April 12, 1926

To the Chief Justice and Associate Justices of the Court of Claims:

Your petitioner, Samuel J. Kornhauser, respectfully represents to your Honors:

I

That he is a citizen of the United States and a resident of Cleveland, State of Ohio; that he duly filed his income tax return for the calendar year 1918, as provided by the Revenue Act of 1918 in which said return he claimed as a deduction from his gross income the sum of $10,000, being the amount paid by him during the said year 1918 for attorney's fees incurred in defending in the courts in the State of Ohio an action against him for an accounting instituted by his former co-partner, said action growing directly out of the conduct of the business of himself and his co-partner in the practice of law in said City of Cleveland in the State of Ohio, it being alleged by his said co-partner that your petitioner had collected fees or compensation for profes-
[fol. 3] sional services performed during the existence of the said co-partnership, to a division of which the said co-partner claimed to be entitled; that the alleged fees in fact consisted of stock in the National Tool Company which was acquired by this petitioner subsequent to the dissolution of said partnership and not in any manner in payment for legal services performed during the existence of said partnership; that your petitioner was successful in the defense of the said and throughout all the courts wherein the case was heard and finally determined and the said expense so incurred your petitioner believed and alleges was a necessary expense incurred in connection with his business within the meaning of sub-paragraph (1) of Section 214 (a) of the Revenue Act of 1918 or else a loss incurred in connection with his business within the meaning of sub-paragraph (4) of said Section 214 (a) and in either event was deductible from his gross income within the purview and meaning of the Revenue Act of 1918 in determining the amount of his net income upon which his income tax liability was to be determined, since it was paid out during

that year and not compensated for by insurance or otherwise.

II

Notwithstanding the facts as hereinbefore set forth, the Commissioner of Internal Revenue refused to permit your petitioner to have the aforesaid deduction and by virtue thereof his gross income and his net income were increased by that amount which resulted in an assessment against him by the said Commissioner of an additional tax due directly thereto in the amount of $1,126.15, which upon demand of the Collector of Internal Revenue at Cleveland, Ohio, was paid on, to wit, March 24, 1924, to the Collector [fols. 4-6] of Internal Revenue at Cleveland, Ohio, and which amount has subsequently been paid over to or covered in the Treasury of the United States.

Your petitioner on, to wit, the twenty fourth day of March, 1924, duly filed with the Commissioner of Internal Revenue his claim for a refund of the said taxes but the said Commissioner did on, to wit, September 22, 1924, reject the said claim.

III

Your petitioner further avers that he has not in any way aided, abetted or given encouragement to rebellion against the United States, that the facts set forth herein are true; that he was never assigned the said claim nor any part thereof but has always been and is now the sole owner thereof, and that he is justly entitled to recover of and from the United States the sum of $1,126.15 together with interest thereon from March 24, 1924.

Wherefore, the premises considered, your petitioner prays judgment against the United States for the sum of $1,126.15 with interest as aforesaid.

Samuel J. Kornhauser, Plaintiff. L. L. Hanby, Attorney for Plaintiff.

State [illegible] *to by Samuel J. Kornhauser. Jurat omitted in printing.*

[fol. 7] III. Demurrer—Filed May 27, 1926

Comes now the Assistant Attorney General in behalf of the defendant and demurs to plaintiff's amended petition on the ground that—

Plaintiff has not set forth a just and legal cause of action against the United States.

Herman J. Galloway, Assistant Attorney General.
Joseph H. Sheppard, Attorney.

IV. Argument and Submission of Demurrer

On October 25, 1926, the demurrer to the amended petition in this cause was argued by Mr. J. H. Sheppard, for the defendant, and by Mr. L. L. Hamby, for the plaintiff.

[fol. 8] V. Opinion of the Court by Moss, J., Sustaining the Demurrer and Dismissing the Amended Petition—Entered November 16, 1926

Moss, Judge, rendered the opinion of the court:

It is alleged by plaintiff in his original petition that in his income-tax return for the calendar year 1918 he claimed as a deduction from his gross income for that year the sum of $10,000, being the amount paid by him for attorney's fees incurred in defending an action against himself for an accounting instituted by his former law partner, in which action it was charged that plaintiff had collected fees for professional services during the existence of the partnership in which his said law partner was entitled to share. The Commissioner of Internal Revenue refused to allow the deduction.

A demurrer was sustained to the original petition, and on plaintiff's motion the court entered its judgment dismissing the petition and granted plaintiff leave to amend.

An amended petition was filed which contains in addition to the matters alleged in the original petition the following language:

"4. [illegible] that the alleged fees in fact consisted of stock in the National Tool Company which was acquired by this petitioner subsequent to the dissolution of said partnership and not in any manner in payment for legal services performed during the existence of said partnership."

The case is now submitted on demurrer to the amended petition and the question for determination is whether or not fees paid to an attorney for defending an action for an accounting instituted by a former law partner may be deducted by the taxpayer from his gross income in making his tax return.

Plaintiff contends that the expenditure is deductible, either as an ordinary and necessary expense in connection with his business under the provision of section 214(a) of the revenue act of 1918, 40 Stat. 1066, which allows deductions for "All ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business"; or else it is deductible as a loss under paragraph 4 of said section which provides for deductions for [fol. 9] "Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business."

The expenditure in question is not an allowable deduction under either provision.

The payment of a fee for legal services under the conditions alleged in the original and the amended petitions is neither an ordinary nor necessary expense incurred in carrying on the trade or business, nor is it a loss sustained in trade or business in the meaning and intent of the statute.

It is a personal expense, and is controlled by section 215 of the same act, which provides, "That in computing net incomes no deduction shall in any case be allowed in respect of—(a) Personal, living, or family expenses."

The amendment, which merely describes the character of the fee, does not in any manner affect the question of law as presented in the original petition.

The demurrer should be sustained and the petition and the amended petition should be dismissed. And it is so ordered.

Graham, Judge; Hay, Judge; Booth, Judge; and Campbell, Chief Justice, concur.

[fol. 10] VI. JUDGMENT

At a Court of Claims held in the City of Washington on the Sixteenth day of November, A. D., 1926, judgment was ordered to be entered as follows:

This case was submitted upon the defendant's demurrer to the plaintiff's petition as amended; on consideration whereof the court is of opinion that the demurrer is well taken. It is therefore adjudged and ordered that the defendant's said demurrer be sustained and that the petition, as amended, be and the same is hereby dismissed.

By the Court.

[fol. 11] Clerk's certificate to foregoing transcript omitted in printing.

Endorsed on cover: File No. 32,336. Court of Claims. Term No. 829. Samuel J. Kornhauser, petitioner, vs. The United States. Petition for writ of certiorari and exhibit thereto. Filed January 12th, 1927. File No. 32,336.

(4494)

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed April 11, 1927

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(6640)

Office Supreme Court, U. S.
FILED
FEB 18 1927
WM. R. STANSBURY
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926.

No. [redacted] 162

SAMUEL J. KORNHAUSER, PETITIONER,

v.

UNITED STATES OF AMERICA, RESPONDENT.

BRIEF ON BEHALF OF PETITIONER IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

L. L. HAMBY,
Attorney for Petitioner.

INDEX

	Page
Statement of the case	1
The facts	2
Pertinent provisions of the statute	3
Argument	4
What is a necessary business expense?	5
What is a loss arising from business?	7
Items not deductible	8
Electric Reduction Co. case	14

Table of Citations

Sections 214 and 215, Revenue Act of 1918	3
Treasury Department Cumulative Bulletin No. 2 (Revision No. 451), page 157	5
Treasury Department Cumulative Bulletin No. 3, page 121	6
Treasury Department Regulations 45, Article 204, Revenue Act of 1918	9
Lacombe v. Eisner, 275 Fed., 304	11
Electric Reduction Company v. Llewellyn, 11 Fed., 2d Series, 493	14
Llewellyn v. Electric Reduction Company, No. 304, October Term, 1926, pending in Supreme Court on a writ of certiorari	14

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926.

No. 829.

SAMUEL J. KORNHAUSER, PETITIONER,

v.

UNITED STATES OF AMERICA, RESPONDENT.

BRIEF ON BEHALF OF PETITIONER IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

Statement of the Case.

The primary question presented by the petition filed herein has arisen from the decision of the Court of Claims which holds that the amount expended by the petitioner in the year 1918 in payment of the fees of an attorney for defending him in a suit for an account

ing in the courts of the State of Ohio, wherein the plaintiff alleged that this petitioner had collected fees to a division of which the plaintiff claimed to be entitled, was not deductible by petitioner from his gross income in computing the tax upon his net income according to the purport and intent of the Revenue Act of 1918.

The case was submitted in the court below on a demurrer to the amended petition, wherein petitioner was the plaintiff and respondent the defendant. The facts set forth in the said amended petition are therefore admitted to be true.

The court below sustained the demurrer and dismissed the amended petition; wherefore the petition for a writ of certiorari herein was filed.

The Facts

Stated briefly, the only material facts are as follows: A suit for an accounting was instituted in the courts of Ohio against petitioner by his former law partner, who alleged therein that subsequent to the dissolution of the copartnership petitioner had collected as a fee for legal services performed while the partnership was in existence certain stock in the National Tool Company, to an accounting for which the plaintiff claimed to be entitled. The said stock was not received by petitioner in payment for legal services performed while the partnership was in existence, and he successfully defended in the courts of Ohio the suit brought by his former copartner, and at the conclusion

thereof, in the year 1918, paid the attorney who defended him a fee of ten thousand dollars ($10,000).

Pertinent Provisions of the Statute to be Interpreted.

Under the heading "Deductions allowed" of Title II of the Revenue Act of 1918, the statute provides as follows:

> "SECTION 214 (*a*). That in computing net income there shall be allowed as deductions:
>
> "(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *
>
> "(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business;
>
> "(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *"

Immediately after the foregoing provisions, the statute provides, under the heading entitled "Items not deductible," as follows:

> "SECTION 215. That in computing net income no deduction shall in any case be allowed in respect of—
>
> "(*a*) Personal, living, or family expenses;
>
> "(*b*) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate;

"(c) Any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made; or * * *."

ARGUMENT.

Petitioner contends that the amount expended by him was deductible under paragraph (1) or (4) or (5) of Section 214 (*a*) above, but the court below has held that it was not deductible because it was an expenditure coming within the provisions of paragraph (*a*) of Section 215 above.

This is an important question of Federal law which has not been, but which petitioner believes should be, settled by this Court.

Furthermore, the court below has placed the expenditure in this case in the category of a voluntary personal, family, or living expense, and thus attempted to discriminate in the character of expenses that a taxpayer may incur under the provisions of paragraph (1) of Section 214 (*a*), and likewise in the character of the loss which a taxpayer may suffer within the provisions of paragraphs (4) and (5) of Section 214 (*a*). Petitioner believes that this contravenes the intention of those provisions.

The effect of the decision of the court below is to penalize petitioner for defending himself, for, had he acceded to the demands, the amount so expended would ordinarily have been deductible from his gross income and in a much larger amount.

The question involved in this case from its very nature seriously affects inherently the rights and liability of every citizen of the United States who may be engaged in business and subject to the payment of income taxes.

What is a Necessary Business Expense?

It cannot be doubted that, had not petitioner been engaged in business with his former copartner, the suit for an accounting could not have been instituted. The expense of defending himself, therefore, was incurred primarily and exclusively because of his business and was a necessary expense within the meaning of paragraph (1) of Section 214 of the statute. The petitioner having not acceded voluntarily to the demands of the suit, the expense of defending it was involuntarily and unavoidably incurred, hence necessary.

The whole of the Revenue Act under consideration is a statute which deals exclusively with the imposition of a tax imposed upon income, gain, or profit, and not with things which bear no relation thereto.

The Treasury Department, in an official document entitled "Cumulative Bulletin No. 2," at page 157, sets forth, as Decision No. 451, in regard to its construction of paragraph (1) of Section 214 (*a*) (*supra*), the following:

> "The test is whether an expense is incurred primarily because of business as the immediate cause of incurring the expenditure."

Can it be seriously contended that the expense of defending a suit for an accounting, arising solely out of the conduct of one's business, is other than one coming directly within this test?

In Cumulative Bulletin No. 3, a similar official document issued by the Treasury Department, there appears, on page 121 thereof, the Department's decision in a case, the material portions of which are as follows:

> "A tenant at work on the farm of a taxpayer was injured. In defending suit for damages on account of negligence, the taxpayer incurred expenses for attorney's fees.
>
> "It is held that if the taxpayer was engaged in farming he was carrying on a trade or business, and that the attorney's fees constituted compensation for personal services actually rendered, which is deductible as an *ordinary* and *necessary* expense. If the farm was rented, the amount so paid is deductible as a business expense incident to the carning of the rent" (Sec. 214(a), (1). (Italic letters ours.)

The foregoing references to the decisions of the Treasury Department are cited merely for the purpose of indicating the contemporaneous executive construction of the particular section of the statute herein considered.

It is a matter of common knowledge that railroads, manufacturers, and industrial companies, as well as individuals and firms, are called upon to defend suits against them relating to the business in which they are engaged. Many of these claims are spurious, many of

them wholly or partly justifiable, and others unjustifiable. They must be defended, however, or else the demands must be met. If they are not defended, the amount paid would generally be far in excess of the amount which attorneys would charge to defend such claims, and thus the resulting net income would be reduced *pro tanto*. If this were not generally true, the legal profession would truly be an unnecessary evil. By defending such suits, one is enabled to conserve as much as possible of his net income, which redounds to the profit of the Government in the imposition of the tax upon his income. Because one should undertake to defend himself and thus conserve more of his net income than he would conserve should he accede to demands made against him, and thus enable him to report a larger net income, must he be penalized by being told that the cost of his defense was neither a necessary expense nor a loss, and that he shall pay taxes upon this amount so expended and not deduct them? Such a situation would seem anomalous.

What is a Loss Arising from Business?

Let us now briefly consider, not alternatively nor disjunctively, but conjunctively, whether the amount expended by petitioner was a deductible loss contemplated in paragraph (4) of Section 214(a) of the statute. If the loss were incurred in trade or business and not compensated for by insurance or otherwise, it is deductible.

The petitioner did not voluntarily make this expenditure as an investment for the purpose of acquir-

ing any property, but involuntarily in defense of a spurious claim for an accounting. The amount so expended was a total loss, the antithesis of an investment, and it cannot be recovered, nor was the petitioner compensated therefor by insurance or otherwise.

There is still another reason why the expenditure should be deducted. If the expenditure were incurred in any transaction entered into for profit, though not connected with the trade or business, it is deductible, if not compensated for by insurance or otherwise, under the provisions of paragraph (5) of said Section 214(*a*).

The transaction by which petitioner received the fee, to which the suit against him related, could scarcely be termed other than a transaction entered into for profit, since lawyers do not customarily engage in business for pleasure alone. The statute does not attempt to define the kind of transaction which shall be entered into for profit, and therefore it was without limitation.

Items Not Deductible.

The court below in its opinion has held that the expenditure in this case is controlled by Section 215 of the statute, which, as hereinabove referred to, provides:

> "That in computing net income no deduction shall in any case be allowed in respect of—
>
> "(*a*) Personal, living or family expenses" (Rev. 8).

The court in its opinion gives no reason for holding that the expenditure in this case comes within the

above quoted provisions of Section 215 other than to say that it is a personal expense, nor does it give any reason why it is not deductible under paragraphs (1) or (4) of Section 214(*a*) other than to say that the amount expended was neither a necessary expense in carrying on a trade or business nor a loss sustained in trade or business within the meaning of the statute (Rec. 8).

The Treasury Department, in Article 291 of Regulations 45, promulgated under the Revenue Act of 1918, enumerates various items which are intended as illustrations of the character of expenses which are personal and not deductible. These are such expenses as insurance paid on a dwelling in which one *lives* (not one rented for profit), life insurance, and rent of a house in which one lives. In each of these instances there is a direct connection between the expenditure and the taxpayer's person, or his home, or his family. All expenditures made by an individual are in a sense personal, because they are made by the individual and no one else. We interpret the meaning of Sections 214 and 215 of the statute, considered together as successive provisions of the statute, to be that if the expenditure by an individual, which must of necessity be *personal*, arise in connection with or as the direct result of engaging in *trade* or *business*, not involving the making of an investment resulting in the acquisition of property, it is deductible; but if the expenditure did not arise because of his engaging in business, but, on the contrary, should bear no relation to his business or trade, it is not deductible. The reason why it is not

deductible in the latter instance is because the expenditure was not incurred in regard to anything which affects the business of earning income. The familiar doctrine *noscitur a sociis* is peculiarly applicable in interpreting what was meant by the expression "personal, family or living expenses." In applying this doctrine, the word "personal" means an expenditure relating to the person himself, and not the business in which he is engaged, and contemplates expenditures for clothing, recreation and amusement, and the innumerable other expenses in which a person may indulge voluntarily for pleasure or because of a duty. A family expense we interpret to mean one which a person incurs on behalf of his family unrelated to his business. It may be for the support of his family in the purchase of food and clothing or it may be for amusement or recreation of his family or medical attendance or any other expense relating to the person. A living expense we interpret to mean one which is incurred in defraying the cost of subsistence of the person or the subsistence of the person's family. In interpreting the statute, as well as applying the doctrine to which we have referred, we must give the language used in the statute its ordinary, everyday meaning, and not apply some possible definition of the words which may be foreign to the context.

It seems clear, therefore, that Section 214, preceding as it does Section 215, contemplates the allowance of all deductions expenditures made by individuals if they relate or directly bear upon his business or trade, and do not involve the acquisition of property as a

capital investment, and that Section 215, following as it does, contemplates excluding as deductions (*a*) only those personal expenditures of an individual which relate to his person, the subsistence of his person and his family, and (*b*) expenditures in the nature of capital investments, although connected with the business of the individual.

Thus (*b*) of Section 215 seems to be in the nature of a limitation or exception to the provisions of Section 214, and therefore to be strictly construed, for, were it not for the provisions of paragraph (*b*) of Section 215, the expenditures therein contemplated may have been deductible as an expense incurred in carrying on a trade or business.

The application of paragraph (*b*) of Section 215, relating to items not deductible, is well exemplified in the decision of the U. S. District Court for the Southern District of New York in the case of Laemmle *v.* Eisner, 275 Fed., 504. In this case the decision of the court is embraced in one sentence, which is as follows:

> "After a full consideration of the facts of this case, I am constrained to the view that the sum of attorney's fees paid in the litigation *for the purpose of the Horsley stock, resulting in practically the ownership or control thereof and the consequent management of the company, under the facts and circumstances disclosed by the record*, constituted a capital investment, and not a 'necessary expense actually paid in carrying on the business,' deductible from income derived from such business." (Italic letters supplied.)

In this case it is perfectly obvious that the expenditure was not incurred in carrying on any trade or business or as the result of anything of that sort, but, on the contrary, it constituted an expenditure incurred in connection with an effort to procure the mastery of the stock of a certain company, which would result in the practical ownership and control thereof. No question of a loss was or could be involved in this case, since the facts recited by the court, and upon which its decision was based, show that Laemmle, in his effort to control the stock of the company and gain the management thereof, induced one Horsley to sell him the stock coveted by an option held by another person. This other person brought a suit against Laemmle and the Universal Film Manufacturing Company to enforce his right under the option. No trial was ever had, but, instead, a settlement was reached whereby the stock in question was divided by agreement among the parties in such a manner that Laemmle finally succeeded in retaining control of the company. His attorneys effected this settlement for him, and the amount of the fees paid these attorneys was claimed as a necessary expense. The court held that, in the circumstances of the case, the attorneys' fees were incurred primarily for the purpose of acquiring an investment and not in defense of any matter arising in connection with the carrying on of any trade or business of the plaintiff. Obviously, the business of the Horsley company was not the business of Laemmle, but in the case at bar your petitioner was defending an action against him in connection with

a suit for an accounting, arising over what was alleged to be fees earned in connection with the business carried on by petitioner.

It is not difficult to perceive that, where an individual desiring to acquire what he considers to be a valuable parcel of real estate as an investment employs a real-estate agent or an attorney to devise a plan whereby he can accomplish the ownership of such property as an investment, the commissions paid or the fees paid, if successful, are neither ordinary nor necessary expenses incurred in any trade or business in which he is engaged, nor do they constitute a loss similarly incurred, but rather an expenditure in aid of acquiring an investment and, as such, is added to the cost of the property so acquired as a part thereof.

In order to distinguish clearly between the intent of paragraph (a) of Section 215 and paragraphs (1) and (4) of Section 214, application of only the simplest logic is required to determine which of these sections applies to the case of this petitioner. It is quite plain that the amount expended by the petitioner was a loss, and that it was not compensated for by insurance or otherwise. If it were such a loss, it could not come within the category of a personal, family, or living expense, because neither in the ordinary nor in any extraordinary meaning of the word "loss" could it ever be said that money expended by one to afford himself or his family amusement, recreation, shelter, food, clothing, or medical attention constitutes a loss. There is not a solitary item of expenditure that one could

conceive as coming within the category of those embodied in Section 215 (a) which by any stretch of the imagination could be termed a loss, nor could such an expenditure even come within the category of an ordinary or necessary expense incurred in a trade or business; yet, if the expenditure in this case was in any respect a loss not compensated for by insurance, or if it were a necessary expense arising primarily as the result of engaging in any trade or business, it cannot be placed in the category of a personal, family, or living expense.

Electric Reduction Co. Case.

Attention is invited to the case of Electric Reduction Company v. Llewellyn, 11 Fed. 2d Series, 493, in which this Court, at the present term, granted a petition for a writ of certiorari, being No. 394, October term, 1926, the writ being directed to the Circuit Court of Appeals for the Third Circuit, which had reversed the judgment of the District Court for the Western District of Pennsylvania. The question involved in that case was whether an amount sought as a deduction was deductible as a bad debt ascertained to be worthless during the taxable year and charged off as such, or whether it was deductible as a loss incurred in carrying on a trade or business. In so far as the question of deductibility as a bad debt is concerned, the case bears no similarity to the case of your petitioner, which does not involve that question. The district court held that the amount sought to be deducted was a bad debt, and, as it was

not ascertained to be worthless in the year in which it was deducted, it was not an allowable deduction. The circuit court of appeals held that the amount sought to be deducted was, under the broad provisions of the statute, a loss, and, as such, was deductible in the year in which the loss occurred. The facts in your petitioner's case are not to any extent similar to those in the case cited, but the loss sustained is not only so fully a loss as that in the case cited, but, unlike that case, it is not subject to any restrictions to which a deduction for bad debts is restricted. It follows that, if in the case cited the amount expended is held by this Court to be a loss, the expenditure in this case would obviously be deductible. On the other hand, if the expenditure in the case cited be not held to be a loss, but to be a bad debt subject to the restriction for deduction of bad debts, the right to deduction in the case of this petitioner would still be left undetermined by this Court.

Wherefore it is earnestly urged that the petition for a writ of certiorari herein be granted.

L. L. HAMBY,
Attorney for Petitioner.